Supreme Court of the United States

OCTOBER TERM, 1964

No. 628

UNITED STATES, PETITIONER

vs.

MIDLAND-ROSS CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

INDEX

[fol. A] No. 15,524.

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

MIDLAND-ROSS CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

ON APPEAL FROM
THE JUDGMENT OF THE UNITED STATES DISTRICT COURT,
FOR THE NORTHERN DISTRICT OF OHIO

APPENDIX TO THE BRIEF FOR THE DEFENDANT-APPELLANT
—Filed October 12, 1963

* * * *

[File Endorsement Omitted]

[fols. 1-2] * * *

[fol. 3] * * * *

IN UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO

No. 36,611

INDUSTRIAL RAYON CORPORATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

COMPLAINT—Filed January 9, 1961

COUNT I.

1. Plaintiff is, and at all times referred to herein, has been a corporation organized under and by virtue of the laws of the State of Delaware, with its principal office in

the Eastern Division of the Northern District of Ohio at 660 Union Commerce Building, Cleveland, Ohio.

2. This is an action against the defendant pursuant to Section 1346(a)(1) of Title 28 of the United States Code, Act of June 25, 1948, c. 646, 62 Stat. 933, as amended by the Act of July 30, 1954, c. 648, Section 1, 68 Stat. 589, to recover income tax, excess profits tax and [fol. 4] interest erroneously, illegally and excessively assessed and collected together with interest thereon.

3. Plaintiff duly filed with the District Director of Internal Revenue at Cleveland, Ohio, for the calender year 1952 its United States Corporate Income and Excess Profits Tax Return on June 15, 1953 showing income and excess profits tax due in the amount of $10,964,532.37. Such amount was paid on or before the dates shown below as follows:

March 15, 1953	$4,500,000.00
June 15, 1953	4,271,625.90
September 15, 1953	1,096,453.24
December 15, 1953	1,096,453.23

4. Upon examination of said tax return for 1952 defendant's agents asserted a deficiency in tax for the year 1952 of $298,412.71. On or about June 14, 1957 plaintiff paid defendant's authorized representative the full amount of the asserted deficiency plus interest of $76,025.75, making a total of $374,438.46.

5. On or about March 14, 1958 plaintiff duly filed with the District Director of Internal Revenue, Cleveland, Ohio, its claim for refund of United States income and excess profits tax for the year 1952 in the amount of $111,718.24 or such greater amount as was legally refundable plus interest as provided by law. A copy of said claim for refund is attached hereto and made a part hereof as Exhibit A. On or about June 9, 1958 plaintiff duly filed with the District Director of Internal Revenue, Cleveland, Ohio, an amended claim for refund of United States income and excess profits tax for the year 1952 in the amount of $130,813.27 or such greater amount as was legally refundable plus interest as provided by law. A copy of said amended claim for refund is attached hereto and made a part hereof as Exhibit B.

6. On or about January 14, 1959 plaintiff executed and duly filed a Waiver of Registered Mail Notification of Claim Disallowance (Form 2297) with respect to its above described claim for refund.

[fol. 5] 7. During the year 1952 plaintiff had gains from the sale of certain non-interest bearing notes some of which it had held for more than six months and some of which it had held for less than six months. Such notes were held by plaintiff as investments and constituted capital assets in its hands. On its income and excess profits tax return for the year 1952 plaintiff properly reported the gain on the sales of such notes held for more than six months as long term capital gain. It properly reported the gain on the sales of such notes held for less than six months as short term capital gain. A description of the notes and the sales setting forth the amounts of such gains is attached hereto and made a part hereof as Exhibit C.

8. Upon examination of plaintiff's 1952 United States income and excess profits tax return defendant, through its agents, erroneously treated gain upon the sale of the notes described in paragraph 7 as interest income, included the entire gain in plaintiff's gross income, and disallowed an excess profits credit carryback from 1953 because of his adjustment and a similar adjustment for 1953 as more fully set forth in Count II hereof. Plaintiff has paid the full tax determined upon such basis.

9. Plaintiff has overpaid and defendant and its representatives have illegally assessed, collected and retained from plaintiff an amount as United States income and excess profits tax for 1952 which is erroneously and illegally excessive by at least $130,813.27 plus interest paid thereon of $33,326.92, and defendant and its representatives have at all times erroneously and illegally refused to refund to plaintiff the said sums together with interest as determined by law.

Count II.

10. Plaintiff realleges and incorporates herein by reference each and every allegation contained in paragraphs 1 and 2 as hereinabove set forth.

11. Plaintiff duly filed with the District Director of Internal Revenue at Cleveland, Ohio, for the calendar year [fol. 6] 1953 its United States Corporate Income Tax Return on or before September 10, 1954 showing income tax (but no excess profits tax) due in the amount of $9,585,540.69. Such amount was paid as follows:

March 15, 1954	$4,410,000.00
June 15, 1954	4,410,000.00
September 15, 1954	286,263.66
December 15, 1954	479,277.03

12. Upon examination of said tax return for 1953, defendant's agents asserted a deficiency in tax for the year 1953 of $36,927.93 (including excess profits tax). On or about June 14, 1957 plaintiff paid defendant's authorized representative the full amount of the asserted deficiency plus interest of $7,198.42, making a total of $44,126.35.

13. On or about March 14, 1958 plaintiff duly filed with the District Director of Internal Revenue, Cleveland, Ohio, its claim for refund of United States income and excess profits tax for the year 1953 in the amount of $38,060.56 or such greater amount as was legally refundable plus interest as provided by law. A copy of said claim for refund is attached hereto and made a part hereof as Exhibit D. On or about June 9, 1958 plaintiff duly filed with the District Director of Internal Revenue, Cleveland, Ohio an amended claim for refund of United States income and excess profits tax for the year 1953 in the amount of $18,965.52 or such greater amount as was legally refundable plus interest as provided by law. A copy of said amended claim for refund is attached hereto and made a part hereof as Exhibit E.

14. On or about January 14, 1959 plaintiff executed and duly filed a Waiver of Registered Mail Notification of Claim Dissallowance (Form 2297) with respect to its above described claim for refund.

15. During the year 1953 plaintiff had gains from the sale of certain non-interest bearing notes which it had held for more than six months. Such notes were held by plaintiff as investments and constituted capital assets in

its hands. On its income and excess profits tax return for [fol. 7] the year 1953 plaintiff properly reported the gain on the sales of such notes as long term capital gain. A description of the notes and the sales setting forth the amounts of such gains is attached hereto and made a part hereof as Exhibit C.

16. Upon examination of plaintiff's 1953 United States income and excess profits tax return defendant, through its agents, erroneously treated gain upon the sale of the notes described in paragraph 15 as interest income and included the entire gain in plaintiff's gross income. Plaintiff has paid the full tax determined upon such basis.

17. Plaintiff has overpaid and defendant and its representatives have illegally assessed, collected and retained from plaintiff an amount as United States income and excess profits tax for 1953 which is erroneously and illegally excessive by at least $18,965.52 plus interest paid thereon of $3,696.98 and defendant and its representatives have at all times erroneously and illegally refused to refund to plaintiff the said sums together with interest as determined by law.

COUNT III.

18. Plaintiff realleges and incorporates herein by reference each and every allegation contained in paragraphs 1 and 2 as hereinabove set forth.

19. Plaintiff duly filed with the District Director of Internal Revenue at Cleveland, Ohio, for the calendar year 1954 its United States Corporate Income Tax Return on or before September 15, 1955 showing income tax due in the amount of $7,899,797.87. Such amount was paid as follows:

March 15, 1955	$3,937,500.00
June 15, 1955	3,965,000.00

(The overpayment of $2,702.13 was credited against 1955 income tax liability.)

20. Upon examination of said tax return for 1954 defendant's agents asserted an overassessment of tax for [fol. 8] the year 1954 of $5,606.79. On or about July 12, 1957 defendant's authorized representative paid plaintiff

the full amount of the asserted overassessment plus interest of $678.34, making a total of $6,285.13.

21. On or about March 14, 1958 plaintiff duly filed with the District Director of Internal Revenue, Cleveland, Ohio, its claim for refund of United States income tax for the year 1954 in the amount of $5,660.42 or such greater amount as was legally refundable plus interest as provided by law. A copy of said claim for refund is attached hereto and made a part hereof as Exhibit F.

22. On or about January 14, 1959 plaintiff executed and duly filed a Waiver of Registered Mail Notification of Claim Dissallowance (Form 2297 with respect to its above described claim for refund.

23. During the year 1954 plaintiff had gains from the sale of certain non-interest bearing notes which it had held for over six months. Such notes were held by plaintiff as investments and constituted capital assets in its hands. On its income tax return for the year 1954 plaintiff properly reported the gain on the sales of such notes as long-term capital gain. A description of the notes and the sales setting forth the amount of such gain is attached hereto and made a part hereof as Exhibit C.

24. Upon examination of plaintiff's 1954 United States income and excess profits tax return defendant, through its agents, erroneously treated gain upon the sale of the notes described in paragraph 23 as interest income and included the entire gain in plaintiff's gross income. Plaintiff has paid the full tax determined upon such basis.

25. Plaintiff has overpaid and defendant and its representatives have illegally assessed, collected and retained from plaintiff an amount as United States income and excess profits tax and interest for 1954 which is erroneously and illegally excessive by at least $5,660.42 and defendant and its representatives have at all times erroneously and illegally refused to refund to plaintiff the said sum of $5,660.42 together with interest as determined by law.

[fol. 9] WHEREFORE, plaintiff demands judgment against defendant in the sum of $192,463.11 or in such other amount as the Court may find justly owing by defendant

to plaintiff with interest as allowed by law and its costs herein, together with such other and further relief as the Court may deem just and proper.

THEODORE M. GARVER,
EBEN H. COCKLEY,
Attorneys for Plaintiff.

JONES, DAY, COCKLEY & REAVIS,
Of Counsel.

IN UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO

ANSWER—Filed March 9, 1961

Now comes the defendant, the United States of America, by its attorney, Russell E. Ake, United States Attorney for the Northern District of Ohio, and for its answer:

COUNT I.

I. Admits the averments contained in paragraph 1 of the complaint, except that defendant is without knowledge or information sufficient to form a belief as to the truth of the averment of the location of the principal office of the plaintiff.

II. Admits the averments contained in paragraph 2 of the complaint, except denies the averment that the taxes and interest were erroneously, illegally and excessively assessed and collected.

III. Admits the averments contained in paragraph 3 of the complaint, except denies the dates of payment as averred in paragraph 3. Defendant avers that such payments were made as follows:

[fol. 10]

March 12, 1953	$4,500,000.00
June 19, 1953	4,271,625.90
September 18, 1953	1,096,453.24
December 21, 1953	1,096,453.23

IV. Admits the averments contained in paragraph 4 of the complaint, except denies the date of payment was

June 14, 1957. Defendant avers that the date of payment was June 27, 1957.

V. Admits the averments contained in paragraph 5 of the complaint, except:

(a) Denies that the date of filing of the original claim for refund was March 14, 1958. Defendant avers that the date of such filing was March 17, 1958.

(b) Denies the averments and facts contained in the claims for refund attached to the complaint as Exhibits A and B unless otherwise expressly admitted herein.

VI. Admits the averments contained in paragraph 6 of the complaint.

VII. Denies the averments contained in paragraph 7 of the complaint (including the averments contained in Exhibit C, unless otherwise expressly admitted herein), except the defendant admits that plaintiff realized a profit on the sale of certain notes during the taxable year.

VIII. Admits the averments contained in paragraph 8 of the complaint, except denies that defendant, through its agents, acted erroneously.

IX. Denies the averments contained in paragraph 9 of the complaint.

COUNT II.

X. Admits the everments contained in paragraph 10 of the complaint, except:

(a) The defendant is without knowledge or information sufficient to form a belief as to the truth [fol. 11] of the averment of the location of the principal office of the plaintiff.

(b) Denies the averment that the taxes and interest were erroneously, illegally and excessively assessed and collected.

XI. Admits the averments contained in paragraph 11 of the complaint, except denies that the payment of $479,-277.03 was made on December 15, 1954. Defendant avers that such payment was made on December 21, 1954.

XII. Admits the averments contained in paragraph 12 of the complaint, except denies that the date of payment was June 14, 1957. Defendant avers the date of payment was June 27, 1957.

XIII. Admits the averments contained in paragraph 13 of the complaint, except:

(a) Denies the date of filing of the original claim for refund was March 14, 1958. Defendant avers that the date of such filing was March 17, 1958.

(b) Denies the averments and facts contained in the claims for refund attached to the complaint as Exhibits D and E, unless otherwise expressly admitted herein.

XIV. Admits the averments contained in paragraph 14 of the complaint.

XV. Denies the averments contained in paragraph 15 of the complaint (including the averments contained in Exhibit C, unless otherwise expressly admitted herein), except the defendant admits that plaintiff realized a profit on the sale of certain notes during the taxable year.

XVI. Admits the averments contained in paragraph 16 of the complaint, except denies that defendant, through its agents, acted erroneously.

XVII. Denies the averments contained in paragraph 17 of the complaint.

[fol. 12]

COUNT III.

XVIII. Admits the averments contained in paragraph 18 of the complaint, except:

(a) The defendant is without knowledge or information sufficient to form a belief as to the truth of the averment of the location of the principal office of the plaintiff.

(b) Denies the averment that the taxes and interest were erroneously, illegally and excessively assessed and collected.

XIX. Admits the averments contained in paragraph 19 of the complaint, except defendant is without knowledge or information sufficient to form a belief as to the

truth of the averment that the overpayment of $2,702.13 was credited against 1955 income tax liability.

XX. Admits the averments contained in paragraph 20 of the complaint, except defendant is without knowledge or information sufficient to form a belief as to the truth of the averment that defendant's authorized representative paid plaintiff the full amount of the asserted overassessment plus interest of $678.35.

XXI. Admits the averments contained in paragraph 21 of the complaint, except:

(a) Denies the date of filing of the claim for refund was March 14, 1958. Defendant avers that the date of such filing was March 17, 1958.

(b) Denies the averments and facts contained in the claim for refund attached to the complaint as Exhibit F unless otherwise expressly admitted herein.

XXII. Admits the averments contained in paragraph 22 of the complaint.

XXIII. Denies the averments contained in paragraph 23 of the complaint (including the averments contained in Exhibit C, unless otherwise expressly admitted herein), except the defendant admits that plaintiff realized a profit on the sale of certain notes during the taxable year.

[fol. 13] XXIV. Admits the averments contained in paragraph 24 of the complaint, except denies that defendant, through its agents, acted erroneously.

XXV. Denies the averments contained in paragraph 25 of the complaint.

WHEREFORE, defendant, having answered fully, prays that judgment be entered dismissing plaintiff's complaint with prejudice and that defendant be awarded its costs and such other relief which to the Court may seem just and proper.

....

United States Attorney.

IN UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO

ORDER SUBSTITUTING MIDLAND-ROSS CORPORATION AS PLAINTIFF—Entered May 1, 1962

Upon consideration,

IT IS ORDERED that plaintiff's motion to substitute party plaintiff herein is granted.

IT IS, THEREFORE, ORDERED that Midland-Ross Corporation is hereby substituted for Industrial Rayon Corporation as the plaintiff in this action.

(s) JAMES C. CONNELL,
Chief Judge.

IN UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO

STIPULATION OF FACTS—Filed June 21, 1962

The parties to this action, by their respective counsel, hereby stipulate, for the purposes of this action only, without waiving any right to object to the admissibility or relevancy of any facts set forth herein, and without prejudice to the right of either party to submit other or further [fol. 14] evidence not inconsistent with the facts hereby stipulated, to the truth of the following facts:

1. This Court has jurisdiction of the subject matter of this action and of the parties to this action.

2. On March 28, 1961 the original Plaintiff in this action, Industrial Rayon Corporation (hereinafter called "Industrial"), was merged into Midland-Ross Corporation under the provisions of Sections 1701.78 through 1701.81 of the Ohio Revised Code. Pursuant to the terms of said merger Midland-Ross Corporation was the surviving corporation of the merger and succeeded to all rights of industrial to all of its assets, claims or choses in action. At all times herein relevant the principal offices of both Industrial and Midland-Ross Corporation have been located in Cleveland, Ohio.

3. On June 27, 1957, Industrial paid to defendant $374,438.46, of which $298,412.71 was for United States income and excess profits taxes for the calendar year 1952, and $76,025.75 was for interest in respect of said taxes.

4. On March 17, 1958, Industrial timely filed with defendant a Claim for Refund, a copy of which is attached hereto marked "Exhibit 1," of $111,718.24 of the taxes set forth in paragraph 3 of this Stipulation. On June 9, 1958 Industrial filed with defendant an Amended Claim for Refund, a copy of which is attached hereto marked "Exhibit 2," of $130,813.27 of the taxes set forth in paragraph 3 of this Stipulation.

5. On January 14, 1959, Industrial executed and duly filed a Waiver of Registered Mail Notification of Claim Dissallowance (U. S. Treasury Department Form 2297) with respect to the Claims for Refund described in paragraph 4 of this Stipulation.

6. On June 27, 1957, Industrial paid defendant $44,-126.35, of which $36,927.93 was for United States income and excess profits taxes for the calendar year 1953, and $7,198.42 was for interest in respect of said taxes.

7. On March 17, 1958, Industrial timely filed with defendant a Claim for Refund, a copy of which is attached [fol. 15] hereto marked "Exhibit 3," of $38,060.56 of the taxes set forth in paragraph 6 of this Stipulation. On June 9, 1958, Industrial timely filed with defendant an Amended Claim for Refund, a copy of which is attached hereto marked "Exhibit 4," of $18,965.52 of the taxes set forth in paragraph 6 of this Stipulation.

8. On January 14, 1959, Industrial executed and duly filed a waiver of Registered Mail Notification of Claim Disallowance (U. S. Treasury Department Form 2297) with respect to the original and amended Claims for Refund described in paragraph 7 of this Stipulation.

9. On March 15, 1955, Industrial paid defendant $3,937,500 and on June 15, 1955, Industrial paid defendant $3,965,000, both of which payments were for United States income tax for the calendar year 1954. Industrial duly filed its United States Income Tax return for the calendar year 1954 on September 15, 1955. Of the total amount of $7,902,500 so paid, $8,308.92 was refunded or

credited to Industrial prior to March 17, 1958. On March 17, 1958, Industrial timely filed with defendant a Claim for Refund, a copy of which is attached hereto marked "Exhibit 5," of an additional $5,660.42 of the taxes set forth in paragraph 9 of this Stipulation.

10. On ~~January 14, 1959~~, Industrial executed and duly filed a Waiver of Registered Mail Notification of Claim Dissallowance (U. S. Treasury Department Form 2297) with respect to the claim for refund described in paragraph 8 of this Stipulation.

11. On January 29, 1952, Industrial paid $5,886,-666.66 to the General Motors Acceptance Corporation and received in return therefor three notes of the General Motors Acceptance Corporation, each in the face amount of $2,000,000 payable to bearer on October 27, 1952. Said notes were not in registered form and contained no provision for the payment of interest. Industrial sold one of the aforesaid notes to The National City Bank of Cleveland on October 8, 1952, for a price of $1,996,833.33, resulting in a gain to Industrial of $34,611.11. Industrial [fol. 16] sold the second of said notes to The Cleveland Trust Company on October 15, 1952, for a price of $1,-998,000 resulting in a gain to Industrial of $35,777.78. Industrial sold the third of said notes to the Union Bank of Commerce on October 16, 1952, for a price of $1,998,-166.66, resulting in a gain to Industrial of $35,944.44.

12. On January 29, 1952, Industrial paid $1,955,-416.67 to the Commercial Investment Trust Company and received in return therefor a note of the Commercial Investment Trust Company in the face amount of $2,000,-000, payable to the bearer on December 15, 1952. Said note was not in registered form and contained no provision for the payment of interest. On December 4, 1952, Industrial sold said note to the Union Bank of Commerce for a price of $1,998,166.67, resulting in a gain to Industrial of $42,750.

13. On January 11, 1952, Industrial paid $1,962,-222.22 to the Commercial Credit Company and received in return therefor a note of the Commercial Credit Company in the face amount of $2,000,000, payable to the bearer on October 9, 1952. Said note was not in registered form and

contained no provision for the payment of interest. On October 8, 1952, Industrial sold said note to The National City Bank of Cleveland for a price of $1,999,833.33, resulting in a gain to Industrial of $37,611.11.

14. On October 22, 1952, Industrial paid $996,166.66 to the Commercial Credit Company and received in return therefor a note in the face amount of $1,000,000, payable to the bearer on December 30, 1952 and in addition, on October 22, 1952 paid $996,166.67 to the Commercial Credit Company and received in return therefor another note, also in the face amount of $1,000,000 payable to the bearer on December 30, 1952. Said notes were not in registered form and contained no provision for the payment of interest. On December 22, 1952, Industrial sold one of said notes to The Cleveland Trust Company for the price of $999,333.33, resulting in a gain to Industrial of $3,166.67. On December 22, 1952, Industrial sold the [fol. 17] other of said notes to the Union Bank of Commerce for the price of $999,333.33, resulting in a gain to Industrial of $3,166.66.

15. On January 15, 1953, Industrial paid $982,385.42 to the Commercial Credit Company and received in return therefor a note of the Commercial Credit Company in the face amount of $1,000,000, payable to the bearer on October 9, 1953. Said note was not in registered form and contained no provision for the payment of interest. On September 30, 1953, Industrial sold said note to The National City Bank of Cleveland for the sum of $999,187.50, resulting in a gain to Industrial of $16,802.08.

16. On January 15, 1953, Industrial paid $982,385.42 to the Commercial Investment Trust Co. and received in return therefor a note of the Commercial Investment Trust Co. in the face amount of $1,000,000, payable to the bearer on October 9, 1953. Said note was not in registered form and contained no provision for the payment of interest. On September 30, 1953, Industrial sold said note to The National City Bank of Cleveland for a price of $999,187.50, resulting in a gain to Industrial of $16,802.08.

17. On February 17, 1953, Industrial paid $982,253.47 to the General Motors Acceptance Corporation and received in return therefor a note of the General Motors

Acceptance Corporation in the face amount of $1,000,000, payable to the bearer on November 13, 1953. Said note was not in registered form and contained no provision for the payment of interest. On November 9, 1953, Industrial sold said note to the Union Bank of Commerce for the price of $999,666.67, resulting in a gain to Industrial of $17,413.20.

18. On February 23, 1953, Industrial paid $982,358.42 to the General Motors Acceptance Corporation and received in return therefor a note of the General Motors Acceptance Corporation in the face amount of $1,000,000, payable to the bearer on November 17, 1953. Said note was not in registered form and contained no provision for the payment of interest. On November 9, 1953, Industrial sold said note to the Union Bank of Commerce for a price [fol. 18] of $999,333.33, resulting in a gain to Industrial of $16,947.91.

19. On June 1, 1954, Industrial paid $1,982,416.67 to the General Motors Acceptance Corporation and received in return therefor a note of the General Motors Acceptance Corporation in the face amount of $2,000,000, payable to the bearer on December 29, 1945. Said note was not in registered form and contained no provision for the payment of interest. On December 27, 1954, Industrial sold said note to The National City Bank of Cleveland for a price of $1,999,833.34, resulting in a gain to Industrial of $17,416.67.

20. On June 1, 1954, Industrial paid $495,583.33 to the Commercial Investment Trust, Inc., and received in return therefor a note of Commercial Investment Trust, Inc. in the face amount of $500,000, payable to the bearer on December 30, 1954. Said note was not in registered form and contained no provision for the payment of interest. On December 27, 1954, Industrial sold said note to The National City Bank of Cleveland for a price of $499,937.50, resulting in a gain to Industrial of $4,354.17.

21. The plaintiff objects to the admissibility of the statement in paragraphs 11 through 20 of this Stipulation that each of the notes described in such paragraphs was not in registered form, on the ground that such statement is irrelevant and immaterial.

22. In the case of each of the notes described in paragraphs 11 through 20 of this Stipulation, the amount paid by Industrial to the maker of the note was calculated by subtracting from the face amount of the note an amount determined by multiplying the face amount by an agreed percentage, dividing the product by 360 and multiplying the result by the number of days from the date of such payment to the maturity of the note. The agreed percentage was determined on the basis of the consideration of several factors, including the prevailing interest rates for borrowers with the credit standing of the obligor for notes of the duration involved and the availability and [fol. 19] need for cash funds. Although different emphasis may be placed on the varying factors in different situations, these are the same factors which Industrial and these makers normally consider in negotiating for the investment of funds and the securing of funds by borrowing or other means.

23. All the notes described in paragraphs 11 through 20 of this Stipulation were capital assets in the hands of Industrial which were sold in bona fide sales to the purchasers thereof.

24. In negotiating the sale price of the notes described in paragraphs 11 through 20, Industrial and the purchasers of the notes considered the face amount of the obligations, the credit of the obligor, the period of time between the purchase and the maturity of the notes, the prevailing interest rates, and the availability of cash funds. Although different emphasis may be placed on the varying factors in different situations, these factors plus the interest rate, if any, are the same factors which these purchasers normally consider in negotiating for the purchase of any corporate obligation. Upon consideration of these factors, the resulting price for the notes was then calculated on the basis of a specific yield, which varied from 1½% to 3% per 360 day year, to the purchaser for the period between the date of purchase and the maturity date of the note.

25. In deciding to sell the notes described in paragraphs 11 through 20 of this Stipulation instead of holding them to maturity, Industrial was motivated by a de-

sire to have the gain taxed as capital gain rather than as ordinary income. (Plaintiff objects to the admissibility in evidence of the facts set forth in this paragraph on the grounds that they are irrelevant, immaterial and incompetent.)

26. Industrial acquired and disposed of notes similar to those described in paragraphs 11 through 20 of this Stipulation regularly for several years prior to and following the years in issue. Such acquisitions, and the acquisition of the notes described in paragraphs 11 through 20 of this Stipulation, were made by Industrial for the purpose of temporary investment of funds not currently [fol. 20] required for its operations in such manner as to produce the maximum available contribution to net corporate earnings consistent with maximum liquidity and safety.

27. The gain to Industrial referred to in paragraphs 11 through 20 was included by Industrial in its federal income tax returns for the years 1952, 1953 and 1954 as capital gain, partly long term and partly short term. Following the audit of such returns by the Internal Revenue Service, all of such gain was included in Industrial's taxable income as ordinary income, and the resulting additional tax was paid as hereinabove set forth. If such gain is properly includable in taxpayer's income as capital gain, plaintiff is entitled to refunds of such taxes, the amount of which shall be computed by the parties, subject to the review of the Court.

THEODORE M. GARVER,
Attorney for Plaintiff,
Midland-Ross Corporation.

JONES, DAY, COCKLEY & REAVIS,
Of Counsel,

....
Attorney for Defendant.

IN UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO

MEMORANDUM ON TAX TREATMENT OF ORIGINAL ISSUE DISCOUNT—Filed March 11, 1963

KALBFLEISCH, *J.*

This is a suit to recover income and excess profits taxes for the years 1952, 1953 and 1954. The taxpayer is the Midland-Ross Corporation, successor in interest to the Industrial Rayon Corporation. During the period in question, for the purpose of temporarily investing funds not then currently required for its operation, the taxpayer [fol. 21] purchased thirteen notes, the face amounts of which varied from $500,000 to $2,000,000. These notes bore no interest, but rather were purchased at a discount by the taxpayer from the maker. Each of the notes was a time instrument.

Before maturity each note was sold to a financial institution at a price which was in excess of the price which had been paid to the maker but below the face amount.

The price paid by the taxpayer to the maker of each note was calculated by subtracting from the face amount a figure determined by multiplying the face amount by an agreed percentage, dividing the product by 360, and multiplying the result by the number of days from the date of such payment to the maturity of the note. The agreed percentage was determined on the basis of the consideration of several factors, including (1) the prevailing interest rates for notes of such duration made by borrowers with credit standings of the obligor, (2) the availability of such notes to prospective purchasers, and (3) the maker's need for cash funds. All of the notes were capital assets in the hands of the taxpayer and were sold by it in bona fide sales. In negotiating the sale price of the notes, the following factors were considered: (1) the face amounts of the obligations, (2) the credit rating of the obligor, (3) the period of time between the sale and the maturity of the notes, (4) the prevailing interest rates, and (5) the amount of cash funds available to the purchaser.

In this three-year period the taxpayer realized a total appreciation of more than $280,000 on these notes. It

contended that this appreciation was a capital gain, while the Internal Revenue Service contended that it was regular income. The taxpayer paid taxes at the regular income rate, and is here seeking a refund.

The relevant sections of the Internal Revenue Code are: Section 117(a)(1)(2) and (4) and Section 111(a) of the 1939 Code, and their counterparts in the Code of 1954.

Section 117(a)(1) of the 1939 Code defines a capital asset as:

[fol. 22] "* * * property held by the taxpayer (whether or not connected with his trade or business), but does not include * * *

> (D) an obligation of the United States or of any of its possessions, or of a state or territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue."

Subsections (2) and (4) of Section 117(a) provide that a capital gain is a gain from the sale of a capital asset, and Section 111(a) provides that the gain from the disposition of property is the "excess of the amount realized therefrom over the adjusted basis * * *."

Plaintiff stresses the fact that the language of the statute, especially of Section 117(a)(1) defining a capital asset, is broad and sweeping. It contends that because these notes were capital assets the gain realized thereon was a capital gain. It contends, further, that in view of Section 117(a)(1)(D), which specifically excludes certain types of discount paper from the category of capital assets, and in view of the failure to exclude such paper as these notes, the Congress clearly indicated its intention that the gain achieved on the sale of such notes constitutes capital gain under the maxim of *expressio unius est exclusio alterius.*

The taxpayer's contention is a familiar enough general rule of statutory construction. However, various courts have read certain exceptions into this statute. They have

held that, while it might appear that a literal construction of the statutory language would convert all but the specifically excluded gains into capital gains, the provisions must be construed in the light of their general purpose and the surrounding law. After so doing, these courts have read further exceptions into the statute, which have resulted in the exclusion from capital gains treatment of certain increments which a literal interpretation might in- [fol. 23] dicate were capital gains. See, for example, *Jaglom* v. *Commissioner*, 303 F. 2d 847 (2nd Cir., 1962); *United States* v. *Harrison*, 304 F. 2d 835 (5th Cir., 1962). In view of the fact that these statutory sections have not been interpreted to include all of the transactions which the sweeping scope of their language might indicate were within their purview, the Court is constrained to hold that this argument is not dispositive of the case.

The Government contends that the realized increment was in fact interest paid for the use of money, and was therefore regular income to the taxpayer. It contends that this is but another instance for application of the well recognized rule that when a taxpayer combines the sale of a right to receive ordinary income with the sale of a capital asset the ordinary income is not converted into a capital gain by its sale in combination with the capital asset. *Fisher* v. *Commissioner*, 209 F. 2d 513 (6th Cir., 1954), cert. den. 347 U. S. 1014; *Commissioner* v. *Morgan*, 272 F. 2d 936 (9th Cir., 1959); *Rosen* v. *United States*, 288 F. 2d 658 (3rd Cir., 1961); *United States* v. *Harrison*, 304 F. 2d 835 (5th Cir., 1962); and *United States* v. *Langston*, 308 F. 2d 729 (5th Cir., 1962).

The taxpayer does not dispute the general validity of this proposition. Its principal contention, however, is that the rule is inapplicable on these facts because the increment, for purposes of taxation at least, was not interest. It fully admits that if these notes had borne interest at a stated rate, and if it had then sold such notes before maturity at an increase in price, the amount of such increase allocable to the proportion of the interest earned to the date of sale would have been regular income under the rule of *Fisher* v. *Commissioner* and the other cases cited, *supra*. However, it contends that a different result is achieved when, instead of the notes bearing interest at

a fixed rate, they were originally sold at a discount. The taxpayer urges that there has been a continuous history of legislative, administrative and judicial interpretation since 1920 which has consistently held that original issue discount in the hands of a cash basis taxpayer is not in-
[fol. 24] come, and that the appreciation resulting therefrom is not taxed as regular income but, rather, as a capital gain.

If it is true that historically the law has not considered such original issue discount as interest, but has removed it from the broad category of regular income and placed it within the specific classification of capital gain, then the increment in this case was not income and the general rule upon which the Government relies is inapplicable. The Court, therefore, must proceed to examine the treatment which such discount has traditionally received.

Commissioner v. *Caulkins*, 144 F. 2d 482 (6th Cir., 1944) is the primary cornerstone upon which the taxpayer rests its contention that the increment here involved was not, for taxation purposes at least, compensation for the use of its money. In that case the taxpayer had purchased an accumulative installment certificate under the terms of which he was to make periodic payments to the seller, who, at the end of ten years, would pay to the taxpayer the sum of $20,000.. This $20,000 was approximately $4,900 more than the total amount of the payments made to the seller. The Commissioner contended that this $4,900 was compensation for the use of the taxpayer's money, and was thus really interest. He held that this interest was regular income, although the taxpayer contended it was a capital gain.

The certificate involved in the *Caulkins* case was in registered form and the decision was based upon an interpretation of Section 117(f) of the Internal Revenue Code of 1939. Section 117(f) provided that amounts received by the holder of registered securities upon their retirement should be considered as amounts received in exchange therefor. The Court held that although the $4,900, at least in many respects, was similar to interest, it was an amount which was received in exchange for the sale of a capital asset and was therefore a capital gain.

To understand the *Caulkins* decision it is necessary to understand the history of Section 117(f). Before the enactment of that section it had been held that retirement of a bond was not such a sale or exchange as would [fol. 25] qualify the amount received upon the retirement for capital gains treatment. See *Fairbanks* v. *United States*, 306 U. S. 436 (1939). Section 117(f) was enacted to avoid this holding. It provided that amounts received upon the retirement of certain evidences of indebtedness which had interest coupons attached, or which were in registered form, should be considered as amounts received in exchange therefor. This provision enabled the amounts received upon the retirement of such bonds to qualify as capital gains. The taxpayer contends that this provision was enacted to accord the same tax treatment to such bonds upon their retirement as always had been accorded them on a sale before retirement. And, according to *Mertens Law of Federal Income Tax*, Volume 38, page 368, M 82:

> "The purpose underlying the enactment of Section 117(f) of the 1939 Code was to accord to the retirement of obligations similar treatment as was then, and is now, accorded to their sale or exchange."

In view of the purpose of Section 117(f), it appears that before the passage of that section amounts received upon the sale of such evidences of indebtedness did qualify for capital gains treatment. If a sale before maturity of such obligations did not permit increments to be accorded capital gains treatment, it is unlikely that the Congress would have deliberately enacted a provision according them such favorable treatment upon retirement.

From the combination of this legislative history with the *Caulkins* decision it is possible to draw the following analogy: Section 117(f), under the *Caulkins* holding, provided that all amounts received in exchange for the retirement of a qualifying capital asset were capital gains. Because Section 117(f) was meant to be declaratory of the preexisting law on sales before retirement, it follows that all amounts received on the pre-retirement sale of such debt obligations were likewise capital gains. The validity of this analogy must be tested by a further in-

[fol. 26] quiry into legislative, administrative and judicial history. However, before proceeding with that history it is necessary to examine the Government's position as to what the *Caulkins* case really held.

The Government contends that *Caulkins* was based solely upon an interpretation of Section 117(f). It says that the crucial fact in *Caulkins* was not that the debt obligations were discount obligations but that a retirement rather than a sale was involved. It has thus attempted to convince the Court that the *Caulkins* decision does not control this case, because in the present instance the notes were sold before maturity, rather than retired. It is true that the opinion in the *Caulkins* case primarily discusses the retirement factor; however, the Court is not convinced that increments on debt obligations which qualify under Section 117(f) would be accorded capital gains treatment if the obligations were retired, but would be taxed at regular income rates if they were sold before maturity. Even the Tax Court, which adopted that position in *Paine* v. *Commissioner*, 23 T.C. 391 (1954), Rev. 236 F. 2d 398 (8th Cir., 1956), and *Stanton* v. *Commissioner*, 34 T.C. 1 (1960), has now abandoned such a distinction. *Gibbons* v. *Commissioner*, 37 T.C. No. 57. The purpose of Section 117(f) surely was not to accord a more favorable tax treatment to income realized upon retirement of debt obligations than it would receive if they were sold before maturity. The quotation from *Mertens*, *supra*, also clearly indicates that such was not the case. Therefore, this Court is constrained to hold that the crucial fact in the *Caulkins* case was that the evidences of indebtedness were discount obligations.

The combination of the *Caulkins* case with Section 117(f) thus indicates that appreciation realized on evidences of indebtedness, issued at an original discount and sold before maturity, constituted a capital gain and not regular income. The remaining question, therefore, is whether the legislative, administrative and judicial treatments of discount obligations support this indication.

[fol. 27] The earliest administrative decision upon this matter which has been furnished to the Court is Office Decision 1024 published in Vol. 2, Cum. Bul. 189 (1920), holding that original issue discount on bonds was not in-

terest and, therefore, was not subject to special withholding provisions when the bonds were in the hands of foreign corporations. It is true, as the Government contends, that this opinion was not concerned with whether an appreciation resulting from such discount was a capital gain or regular income. It was concerned, however, with whether such gain was in fact interest. The opinion carefully examined the various factors involved and came to the conclusion that original issue discount, while in some ways like interest, differed from interest in other respects and was in fact not interest.

The writers appear to have been agreed that in the period following 1920 a taxpayer could not accrue bond discount, but had to report all of it in the year in which it was received. No part of the discount was allowed to be treated as income prorated over the life of the bond. See *Accountant's Handbook*, 2d Ed., p. 339 (1932); Newlowe, *Intermediate Accounting*, p. 205 (1939); and 4 Mertens *Law of Federal Income Taxation*, Section 23.162, p. 298. However, this well established rule does not meet the real issue in question, which is whether the income, in the year in which it was reported, was treated as a capital gain or as regular income. There is, however, one case from this period which again reiterates the fact that discount is not interest. That case is *Corn Exchange Bank* v. *Commissioner*, U. S. Board of Tax Appeals, 6 B. T. A. 158 (1927). Taxpayer had sought to amortize bond discount and premium. The Board of Tax Appeals refused to allow such amorization. In doing so, it said, at page 161:

> "The discount on the bond purchased below par is unlike interest, which is a fixed charge and accrues periodically. The right to receive this discount, or difference between the cost of the bond and its par, cannot be determined in advance as the bond may be sold for more or less than its cost, or, perhaps, as in the case of many bonds, it may be redeemed prior to [fol. 28] its maturity at an amount different from its principal or face amount of the bond. This discount is not earned or accrued in annual installments and can not be income to the holder of the bond, either as additional interest or as a separate item of income."

The Government contends that the *Corn Exchange Bank* opinion was dealing only with regular discount as distinguished from original issue discount. It fully agrees that discount which is the result of such factors as an obligor's default in interest payments does not give rise to ordinary income. However, an examination of both the fact and the opinion in the *Corn Exchange Bank* case fails to reveal that the Court there was discussing any particular kind of discount. A practical examination of the transactions involved leads the Court to conclude that it is extremely likely that both kinds of discount were involved.

This case indicates that during the 1920's the Department of Internal Revenue, which prevailed in the *Corn Exchange Bank* decision, had contended that discount was not interest. And if discount was not interest, income resulting from discount could not have been taxable at regular rates on the premise that it was interest.

In 1940 the Internal Revenue Service held that income realized from the redemption of state discount bonds was interest, and, accordingly, was non-taxible. G. C. M. 21890, 1940-1, Cum. Bul. 85. It said the courts had considered the nature of discount and found it to be like deferred interest. Such discount was, in effect, payment for the use of the money lent. The value of this ruling is questionable, however, because it necessarily involved statutory and constitutional limitations upon the federal taxation of state bonds. And while the ruling held that such discount was like interest, it carefully avoided holding that it was interest. Thus, at least until 1940, and possibly thereafter, the Internal Revenue Service held that discount was not interest. The legislative treatment of bond discount should be viewed against this administrative background.

[fol. 29] In 1929 the Congress authorized the Treasury Department to issue non-interest-bearing discount obligations. The bill authorizing these notes, as passed by the House and as approved by the Senate Finance Committee, contained a provision that, as to profits attributable to the discount, "any gain from the sale or other disposition thereof shall be exempt from all taxation." Congressional Record, Senate, June 4, 1929, p. 2319. This provision for

tax exemption met with considerable opposition upon the floor of the Senate, *because the Senators believed such profits were capital gains*, and feared that such a provision would open the way for the future exemption of all capital gains from taxation. Several members of the Senate engaged in a lengthy debate about the relationship between original issue discount and interest, and the tax consequences that flowed therefrom. That debate indicates that at least some members of the Senate believed that original issue discount was in fact a substitute for interest; but those who purported to be familiar with the subject pointed out that, under the then current practice of the Bureau of Internal Revenue, income attributable to original issue discount was treated as a capital gain and not as regular income. See page 2331, Congressional Record, supra. The question was finally resolved by the insertion of a provision in the bill that amounts received as the result of original issue discount on these notes would be called interest, thus bringing them within the already existing interest exemption. Likewise, a similar provision was added as an amendment to the Second Liberty Bond Act of 1917, Title 31 U. S. C. A., Section 757c (d). Thus, the legislative history indicates that appreciation resulting from this discount was statutorily transformed into interest to avoid its taxation as a capital gain.

These facts further substantiate the taxpayer's contention that during the period of the 1920's and early 1930's original issue discount was not considered interest, but rather gave rise to a capital gain. Furthermore, the Congress was aware of this construction and acquiesced therein by failing to statutorily change the rule until 1954. [fol. 30] See Section 1232a(2)(A), Internal Revenue Code of 1954. This section now provides that, upon the sale or exchange of evidences of indebtedness issued by a corporation or a government, amounts of appreciation attributable to original issue discount will not be considered as gains resulting from the sale or exchange of a capital asset. In other words, in 1954, and governing evidences of indebtedness issued after the ones which are now before this Court, the Congress stated that appreciation resulting from original issue discount would henceforth be considered as regular income and not as capital gain.

The House report accompanying this section stated that under existing law such gains were taxed as capital gains if the bond was held to retirement, and that this section was enacted to change the rule insofar as appreciation resulting from original issue discounts was concerned. 3 U. S. Code Congressional and Administrative News, 1954, p. 4110. The report of the Senate Finance Committee is less helpful. It merely stated that "There is some uncertainty as to the status of proceeds in these transactions, i.e., as capital gain or as interest income where the bond or other evidence of indebtedness has been issued at a discount * * *." 3 U. S. Code Congressional and Administrative News, 1954 p. 4745. In support of its statement that there was some confusion as to the current status of the law, the Senate report compared *Commissioner* v. *Caulkins* to I. T. 3486, 1941-2 Cum. Bul., p. 76. However, the Internal Revenue holding, upon which the Senate Committee relied, dealt only with a specific statutory provision which provided that such gains realized on the sale of Treasury bills should be interest. That provision had been enacted to make such gains non-taxable by bringing them within the exemption which interest enjoyed. Thus, the Senate Report does not cite any evidence of uncertainty insofar as the generally applicable principles are concerned.

At various times the Congress has enacted special provisions regarding the treatment of discount. For instance, the Internal Revenue Code of 1939, Sections [fol. 31] 201(e) and 207(e), provided that stock and mutual life insurance companies must accrue discount.

And in 1938 the House Ways and Means Committee discussed the relationship between discount and interest. That Committee report stated:

> "It is important also to emphasize that there is no clear separation, in practice, between capital gains and ordinary income; * * * *A bond purchased at a premium results in a capital loss when redeemed at par, and a bond purchased at a discount, in a capital gain.*" Hearings on H. R. 9682, Subcommittee of Committee on Ways and Means, 75th Congress, Third Session, p. 39. (Emphasis added.)

Here again is evidence of Congressional knowledge that appreciation due to bond discount was a capital gain. The Subcommittee recommended that no change be made in this rule.

Again, in Section 42(b) of the 1939 Internal Revenue Code, the Congress gave taxpayers an election to treat as current income the periodic increases in redemption value of non-interest-bearing obligations issued at a discount when such obligations were redeemable for fixed amounts which increased at stated intervals.

Thus the evidence indicates that the Congress clearly believed that appreciation resulting from original issue discount was a caiptal gain. With this knowledge Congress adopted various pieces of specific legislation providing for special treatment of discount in certain specified situations. However, Congress took no action to change the general law. These facts indicate a Congressional intention, until 1954, that capital gains treatment continue to be accorded to gains resulting from bond discount. And there was no indication of any thought that different treatment should be given to gains resulting from original issue discount than was accorded those resulting from other types of discount.

Both parties have cited various explanations and public policies underlying the special treatment which the [fol. 32] Congress has accorded to capital gains. As the Government has indicated, there are several reasons for this special treatment. However, even the Government cannot deny that one important reason is to avoid taxing, at unusually high rates, income which has in fact been earned over a number of years but which is realized only in the year of sale. In other words, the accumulation of income actually accrued ever a period of years, but realized only in the year of sale, which is inherent in the profitable sale of most capital assets, would, under our system of highly progressive income taxation, result in a taxation of such income at far higher rates than would have been the case if the income had been reportable in each of the years in which it accrued but was not realized. The capital gains provisions place a limit upon the extent to which such gains can be taxed. In view of this purpose,

it certainly appears that the long-term appreciation, resulting from original issue discount of bonds and other evidences of indebtedness, can be appropriately fitted within that category of appreciation which is accorded the special capital gains treatment.

In several instances the Tax Court has had occasion to consider the proper method of taxing gains resulting from original issue discount. It must be remembered that in the *Corn Exchange Bank* case, *supra*, the Board of Tax Appeals held that discount was not interest. The next occasion on which the Court was faced with the problem was in *Caulkins* v. *Commissioner*, 1 T. C. 656 (1943), where it decided that original issue discount gave rise to a capital gain and not to regular income. It was this opinion which was affirmed by the Sixth Circuit in *Commissioner* v. *Caulkins*, *supra*.

In 1954, on a complex factual situation, it held that discount was really interest and therefore gave rise to regular income when the securities were sold before maturity. *Paine* v. *Commissioner*, 23 T. C. 391 (1954). That holding was reversed by the Eighth Circuit in *Paine* v. *Commissioner*, 236 F. 2d 398 (1956). While it cannot be said that the Eighth Circuit held that discount resulted [fol. 33] in a capital gain, that Court did held that the appreciation involved in the *Paine* case was not interest. The language of the Court further indicates, however, that it did not think that discount created gains which were taxable as regular income.

Another case before the Court was *Commissioner* v. *Morgan*, 30 T. C. 881 (1958), involving accumulative investment certifies identical to those in the *Caulkins* case. The Tax Court held that the appreciation on these certificates was a capital gain. The Commissioner appealed that determination to the Ninth Circuit, which reversed the Tax Court. *Commissioner* v. *Morgan*, 272 F. 2d 936 (1959). The Court of Appeals considered the Sixth Circuit's *Caulkins* decision and refused to follow it. The Court held that Section 117(f) was designed only to allow capital gains treatment to be accorded to "true" capital gains. The Court refused to give the language of

Section 117(f) the all-encompassing scope that it had been accorded by the Sixth Circuit.

The Tax Court reaffirmed its holding that such gains were capital gains in *Goodstein* v. *Commissioner*, 30 T. C. 1178 (1958). And it was again faced with another of the Caulkins-type accumulative investment certificates in *Kormendy* v. *Commissioner*, 18 T. C. M. 353 (1959). This case was decided after *Morgan* but before the reversal of *Morgan* by the Ninth Circuit. Again, the Tax Court affirmed its *Morgan* and *Caulkins* holdings.

Finally, in 1960, after the reversal of the *Morgan* decision by the Court of Appeals, the Tax Court again had a similar problem in *Stanton* v. *Commissioner*, 34 T. C. 1 (1960). In that case the taxpayer had purchased short-term Government notes and commercial paper at a discount. This paper he sold before maturity but after holding for more than six months. The excess of the amount realized over the cost was reported as a long-term capital gain. The Tax Court held that the appreciation was regular income because the notes were sold before maturity. In support of this decision the Court cited its *Paine* opinion, which it said had been reversed on other grounds.

[fol. 34] The most recent case that it has considered was *Gibbons* v. *Commissioner*, 37 T. C. No. 57. In *Gibbons* the Tax Court held that discount was *always* interest, and thus regular income, no matter whether it was realized upon a sale or exchange before retirement, or upon the retirement of a debt obligation. Thus, in *Gibbons*, the Tax Court completely rejected the *Caulkins* decision, and abandoned the distinction that it had made in *Paine* and *Stanton* between gains realized on a sale and gains realized on a retirement.

The problem of original issue discount has been considered recently by a number of constitutional courts. Most of the decisions which were cited to this Court have but again reaffirmed the validity of the general principle for which the Government contends. When the evidences of indebtedness in question were interest-bearing obligations the applicability of this proposition cannot be questioned. Cases which have dealt with the rule in such situations are: *Fisher* v. *Commissioner*, 209 F. 2d 513

(6th Circuit, 1954), cert. den. 347 U. S. 1014; *United States* v. *Langston*, 308 F. 2d 729 (5th Circuit, 1962); *Arnfeld* v. *United States*, 163 F. Supp. 865 (Court of Claims, 1958), cert. den. 359 U. S. 943; and *Jaglom* v. *Commissioner*, 303 F. 2d 847 (2nd Circuit, 1962); cf. *Commissioner* v. *Phillips*, 275 F. 2d 33 (9th Circuit, 1960). Thus, there are only five cases which actually have dealt with the treatment to be accorded to gains resulting from original issue discount. Those cases are: *Commissioner* v. *Caulkins*, 144 F. 2d 492 (6th Circuit, 1944); *Commissioner* v. *Morgan*, 272 F. 2d 936 (9th Circuit, 1959); *Rosen* v. *United States*, 288 F. 2d 658 (3rd Circuit, 1961); *United States* v. *Harrison*, 304 F. 2d 835 (5th Circuit, 1962); and *Pattiz* v. *United States*, Court of Claims No. 219-61 (1963). The *Morgan* and *Rosen* decisions were based upon the same fact situation that was presented to the Sixth Circuit in *Caulkins*. The results in the Third and Ninth Circuits were obtained by a specific rejection of the *Caulkins* decision. In neither case did the Court examine the legislative, administrative or judicial history which has surrounded the treatment [fol. 35] of original issue discount. Instead, the Court was presented with the proposition on an almost *de novo* basis and, perhaps naturally enough in the absence of familiarity with the detailed history, fell back upon the broad, general proposition for which the Government here contends. Likewise, the *Harrison* and *Pattiz* decisions were based upon a specific rejection of *Caulkins* and on an adoption of the *Morgan* and *Rosen* opinions, and neither case considered the historical treatment of original issue discount. Therefore, while it is true that the recent cases have adopted the Government's position, they have done so (1) without a discussion of the historical treatment of gains resulting from original issue discount, and (2) only upon a rejection of the *Caulkins* case, which is controlling in this Circuit.

The following factors support the taxpayer's contention: (1) the opinions of the Department of Internal Revenue and the Board of Tax Appeals, during the 1920's and early 1930's, that discount was not interest; (2) Congressional belief, expressed both in 1929 upon author-

ization of Treasury bills and later in the Second Liberty Bond Act, that original issue discount resulted in a capital gain, and consequent Congressional action to avoid that result; (3) the report of the Subcommittee of the Ways and Means Committee of the House of Representatives, in 1938, that discount gave rise to a capital gain; (4) Congressional enactment of various specific pieces of legislation providing that appreciation resulting from discount would be treated as other than a capital gain; (5) the failure of the Congress to take any action to change the treatment of bond discount except in regard to highly specialized factual situations; (6) the passage of Section 117(f), as interpreted by the *Caulkins* decision, indicating that all amounts received upon retirement, and attributable to original issue discount, were capital gains; (7) the numerous early opinions of the Tax Court that original issue discount resulted in a capital gains; and (8) the fact that none of the cases which have rejected *Caulkins* have considered the historical treatment of bond [fol. 36] discount. Against these factors, and in support of the Government's contention, it is possible to infer, from several administrative rulings dealings with specific statutory situations, that bond discount was really interest and was taxable as regular income. The 1929 Senate debate and the 1938 House hearings refute any possible implication from other Congressional enactments that original issue discount resulted in regular income. The factors supporting the taxpayer's contention are clearly of controlling weight.

It may well be that, in financial circles at least, original issue discount is considered to be a form of interest. If this is the case, it is certainly understandable why the various courts of appeal, which have considered this question on an almost *de novo* basis, have held that original issue discount resulted in regular income to the taxpayer. It is likewise true that there has been a trend—commencing with certain legislative enactments, proceeding through some administrative interpretations, and culminating with the Congressional enactment of 1954—toward classifying appreciation resulting from original issue discount as interest. This trend began with certain

very specific factual situations and expanded to include nearly all governmental and corporate evidences of indebtedness. However, careful study of this developing trend confirms the Court's belief that it has effectuated a change in the law. The facts in this case are not within any of the specific factual situations for which this change has been made and, therefore, the Court is constrained to hold that, as to the notes here in question, the appreciation for taxation purposes was not interest but, rather, an appreciation on capital, and was therefore taxable as a capital gain.

Should it be required, this memorandum will be adopted, as findings of fact and conclusions of law under Section 52(a), Federal Rules of Civil Procedure.

GIRARD E. KALBFLEISCH,
United States District Judge.

[fol. 37]

IN UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO

JUDGMENT—March 27, 1963

The Court, having considered the evidence and the arguments of counsel and having filed a memorandum opinion herein on March 11, 1963, it is in conformity therewith:

ORDERED that the plaintiff have judgment against defendant for the principal amount of $164,140.19 for the taxable year 1952 with interest thereon from June 27, 1957 at 6 percent according to law; $22,662.50 for the taxable year 1953 with interest thereon from June 27, 1957 at 6 percent according to law; and $5,660.42 for the taxable year 1954 with interest thereon from June 15, 1955 at 6 percent according to law; or a total of $192,-463.11 plus interest.

DONE IN OPEN COURT at Cleveland, Ohio, this 27th day of March, 1963.

GIRARD E. KALBFLEISCH,
United States District Judge.

IN UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO

NOTICE OF APPEAL—Filed May 22, 1963

Notice is hereby given that the United States of America, the defendant in the above captioned proceeding, hereby appeals to the United States Court of Appeals for the Sixth Circuit from the Judgment entered by this Honorable Court on March 27, 1963, ordering that the plaintiff, Midland-Ross Corporation, recover from the defendant the sum of $192,463.11 plus interest.

MERLE M. MCCURDY,
United States Attorney,

By BERNARD J. STUPLINSKI,
Asst. United States Attorney.

[fol. 38]

IN THE UNITED STATE COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 15524

[File Endorsement Omitted]

MIDLAND-ROSS CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

On Appeal from the United States District Court, Northern District of Ohio, Eastern Division

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OPINION—July 29, 1964

Before: WEICK, Chief Judge, CECIL, Circuit Judge, and MCALLISTER, Senior Circuit Judge.

PER CURIAM. This cause is before the Court on appeal from a judgment of the United States District Court for the Northern District of Ohio granting judgment in favor of the appellee, a taxpayer, against the United States, the appellant. The sole question presented on the appeal is whether original discount income received upon the sale of notes prior to their maturity is entitled to be treated as capital gains under Section 117(f) of the Internal Revenue Code of 1939.

Judge Kalbfleisch of the District Court wrote a comprehensive opinion in the case in which he followed the ruling of this Court in *Commissioner of Internal Revenue* v. *Caulkins*, 144 F.2d 482. While some courts [1] have taken a

[1] *Dixon* v. *United States*, . . . F.2d . . ., C.A. 2; *Pattiz* v. *United States*, 311 F.2d 947, *Ct.Cl.*; *United States* v. *Harrison*, 304 F.2d 835, C.A. 5, cert.den., 372 U.S. 934; *Rosen* v. *United States*, 288 F.2d 658, C.A. 3; *Commissioner* v. *Morgan*, 272 F.2d 936, C.A. 9.

contrary view on the issue presented we are of the opinion that the *Caulkins* case, controlling in our circuit, was correctly decided.

[fol. 39] The pertinent facts are stated in the opinion of the District Court reported at *Midland-Ross Corp.* v. *United States*, 214 F.Supp. 631. We agree with the opinion of Judge Kalbfleisch and the judgment of the District Court is affirmed.

[fol. 40]

IN THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

JUDGMENT—Filed July 29, 1964

Appeal from the United States District Court for the Northern District of Ohio.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Ohio, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby affirmed.

No costs awarded. Rule 23(4).

Approved for entry:
/s/ Lester L. Cecil
United States Circuit Judge

[fol. 41]

[Clerk's Certificate to foregoing transcript omitted in printing]

[fol. 42]

SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1964

No. 628

UNITED STATES, PETITIONER

v.

MIDLAND-ROSS CORPORATION

ORDER ALLOWING CERTIORARI—December 14, 1964

The petition herein for a writ of certiorari to the United States Court of Appeals for the Sixth Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1965 760028 511